

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-138063-08

Date: March 2, 2009

### Legend:

X =

D1 =

State =

D2 =

D3 =

A =

Trust =

D4 =

n =

Dear :

This responds to the letter dated August 28, 2008, and related correspondence, submitted on behalf of X, requesting relief under §1362(f) of the Internal Revenue Code (ACode®).

### FACTS

The information submitted states that, on D1, X was incorporated under the laws of State. On D2, X elected to be treated as an S corporation for federal tax purposes. On D3, A, shareholder of X, transferred a portion of X stock to Trust, an ineligible shareholder of an S corporation, therefore, terminating X's S election. On D4, X was sold to an unrelated corporate buyer. Shortly before the sale, X and its shareholders discovered the terminating event on D3.

X and its shareholders prior to D4 represent that they had been unaware of the terminating event and did not intend for X's S election to terminate prior to the sale. Further, X and its shareholders prior to D4 have filed federal income tax returns consistent with X's S corporation election until D4. X and its shareholders prior to D4 agree to make such adjustments that the Secretary may require, consistent with the treatment of X as an S corporation until D4.

### LAW AND ANALYSIS

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that a small business corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(v) states that an electing small business trust (ESBT) is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if such trust does not have (1) a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary; (2) no interest in such trust was acquired by purchase, and; (3) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consent, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken - (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

### CONCLUSION

Based solely upon the representations made and the information submitted, we conclude that X's S election terminated on D3, when a portion of X stock was transferred to Trust. We further conclude that the termination was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on and after D3, until D4, unless X's S election is otherwise terminated under § 1362(d), and provided that the following conditions are met.

Within 60 days of the date of this letter, the trustee of Trust must file an ESBT election effective D3 with the appropriate service center. A copy of this letter should be attached to the ESBT election. Further, within 60 days of the date of this letter, Trust and its beneficiary must file amended returns as appropriate for the tax years that are open prior to D4, consistent with the ESBT election.

In addition, as an adjustment under § 1362(f)(4), with 30 days from the date of this letter, a payment of \$n and a copy of this letter must be sent to the following address:

Internal Revenue Service  
Cincinnati Service Center  
Stop 31, Terri Lackey, Manual Deposit  
201 West Rivercenter Blvd.  
Covington, KY 41011

If all of the above conditions are not met, then this ruling is null and void. Further, if these conditions are not met, X must notify Cincinnati Service Center that its S election terminated on D3.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code, including whether X was otherwise eligible to be an S corporation prior to D4, or whether Trust was otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter ruling will be sent to your authorized representatives.

Sincerely,

*Dianna K. Miosi*

Dianna K. Miosi  
Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter  
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